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IN THE

Supreme Court of the United States

October Term, 1953

No.

LESTER MAXWELL, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

The petitioner, Lester Maxwell, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Sixth Circuit entered in the above entitled cause on April 10, 1953.

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 13-24) is not reported. The opinion of the Court of Appeals (R. 33) is reported at 203 F. 2d 567.

JURISDICTION

The judgment of the Court of Appeals was entered on April 10, 1953 (R. 33). The jurisdiction of this Court is involved under Title 28, United States Code, Section 1254(1).

QUESTIONS PRESENTED

1. Whether the Court below erred in affirming the Tax Court's decision that petitioner's wife was not a bona fide member for federal income tax purposes of a partnership conducted under the name of Lester Maxwell Furniture Company?

2. Whether the Court below erred in affirming the Tax Court's holding that petitioner's wife made no capital contribution to the partnership?

STATUTE INVOLVED

The statute involved is Section 182(c) of the Internal Revenue Code (26 U. S. C. § 182(c)) which provides in part as follows:

> SEC. 182 TAX OF PARTNERS.
>
> In computing the net income of each partner, he shall include, whether or not distribution is made to him—
>
> * * * * * * * * *
>
> (c) His distributive share of the ordinary net income or the ordinary net loss of the partnership.

STATEMENT OF THE CASE

Petitioner is an individual residing at Knoxville, Tennessee, and filed his income tax returns for the years here involved with the collector of internal revenue for the district of Tennessee (R. 13-14).

During the period 1919 to January 1, 1944, petitioner conducted a retail furniture business in Knoxville, Tennessee, as a sole proprietorship. In 1929 he engaged his

brother-in-law, Fred H. Human, to assist him in the business. In 1939 and at various times thereafter, Human approached petitioner with respect to securing an interest in the business. In 1940 Marian M. Calloway, daughter of petitioner, and her husband, Hasson Calloway, urged petitioner to sell them an interest in the business. (R. 14.)

In the latter part of 1943 petitioner decided to form a partnership with Fred H. Human, Marian M. Calloway and Hasson Calloway (R. 14). Under date of January 1, 1944 a partnership agreement was executed, reading as follows (R. 14-15):

Articles of Partnership

This partnership shall be known as the Lester Maxwell Furniture Company.

The Partnership is composed of Lester Maxwell, who owns a 50 per cent interest therein, Fred H. Human, who owns a 25 per cent interest therein, Hasson Calloway, who owns a 12-½ per cent interest therein, and Marian Maxwell Calloway, who owns a 12-½ per cent interest therein.

Said partnership shall engage in the retail furniture business in the City of Knoxville, and shall be under the management of Lester Maxwell.

Said partnership shall pay Lester Maxwell a salary for his services and Fred H. Human a salary for his services, so long as said partners continue to devote their time to the business; said salaries to be considered a business expense. After the payment of expenses and salaries set out above, the net profits, if any, shall belong to the partners in the ratio of their interests in said partnership. The salaries of the above partners shall be fixed by agreement of the majority of the partnership, each partner having a vote in the (sic) accordance with the percentage of his interest in the firm. That is, Lester Maxwell shall have 50 votes, Fred H. Human shall have 25 votes, Hasson Calloway 12-½ votes, and Marian Maxwell 12-½ votes.

In the event either partner desires to withdraw, the other partners shall have the first chance to buy his

interest in the partnership at its book value. In the event of the death of either partner, his or her estate shall be bound to give the surviving partners the opportunity to purchase the interest of said deceased partner at its book value before offering said interest to any outsider.

Executed at Knoxville, Tennessee, on this 1st day of January, 1944.

(Sgd.) LESTER MAXWELL
(Sgd.) FRED H. HUMAN
(Sgd.) HASSON CALLOWAY
(Sgd.) MARIAN M. CALLOWAY

Fred H. Human paid for his interest in the partnership by giving petitioner $4,000 in cash and a note for $14,015.26. Hasson Calloway and Marian Calloway, in payment of their interests, each gave petitioner $2,000 in cash and an interest-bearing promissory note for $7,007.63. (R. 16.)

The $4,000 cash which the Calloways paid in was secured from the Hamilton National Bank of Knoxville on an unsecured note. The note was not endorsed by petitioner. The Calloways later paid the note to the bank and the two notes for $7,007.63 each, in installments. (R. 16.)

Sometime after the formation of this partnership Delphia E. Maxwell, the wife of petitioner, felt she should have an interest in it (R. 17). She approached petitioner and asked him to sell her an interest in the business (R. 3, 5, 10, 22),[1] and with the consent of the other partners, in the later part of 1944 petitioner sold her one half of his then interest for the sum of $22,383.61 (R. 17). Delphia E. Maxwell at this time owned two houses in her own right on which she received rents (R. 10).[2] She executed and delivered to petitioner a non-interest bearing note dated January 1, 1945, and payable in 12 months for the full purchase price of her partnership interest (Ex. 10-J, 16; R. 3, 17). Delphia E.

[1] The Tax Court did not find this fact; however, it is supported by the record (citations above), and the Tax Court's opinion wherein it states that she "urged" petitioner to sell her an interest.

[2] This finding was not made by the Tax Court; however, it is clearly supported by the record (citations above).

Maxwell had made (at the time of the trial of this proceeding in the Tax Court) payments totaling $13,500 on the aforesaid note as follows (R. 4, 17):

3- 6-45	$3,000	9-17-47	$1,500
1-16-46	3,000	9-15-48	1,000
6-10-47	1,500	2-24-49	1,000
8-11-47	1,500	1- 3-50	1,000

Delphia E. Maxwell testified that she intended to become a partner in the partnership and the other partners testified that they intended that she become a partner (R. 2, 5, 7, 11; Tr. 93).[3]

Her admission to the partnership was evidenced by the execution on January 1, 1945, by all of the partners of "Amended Articles of Partnership", reading as follows (R. 18):

> AMENDED ARTICLES OF PARTNERSHIP
>
> FOR THE
>
> LESTER MAXWELL FURNITURE COMPANY
>
> WITNESSETH:
>
> That Lester Maxwell, with the consent of the other members of said partnership, has sold to Delphia Maxwell one-half of his interest in this partnership, and that hereafter said partnership shall be composed of the following persons, who have the following shares in said partnership:
>
> | | |
> |---|---|
> | Lester Maxwell | 25 percent |
> | Delphia Maxwell | 25 percent |
> | Fred H. Human | 25 percent |
> | Marian Calloway | 12½ percent |
> | Hasson Calloway | 12½ percent |
>
> The operation of said partnership shall continue as in the past and as operated under partnership agreement dated January 1, 1944, except that in all matters as to salary, operation, and control, the question shall

[3] While the Tax Court did not find these facts, they are facts of record (R. 2, 5, 7, 11; Tr. 93).

be settled by a vote of the members of the partnership as the same is now constituted. That is to say, Lester Maxwell, Delphia Maxwell and Fred H. Human shall have twenty-five votes each and Marian M. Calloway and Hasson Calloway shall have twelve and one-half votes each. All of the other terms of said former partnership are hereby made a part of this agreement.

This January 1, 1945.

(Sgd.) Lester Maxwell
(Sgd.) Fred H. Human
(Sgd.) Delphia H. Maxwell
(Sgd.) Marian M. Calloway
(Sgd.) Hasson Calloway

The formation of the original partnership and the subsequent admission of Delphia E. Maxwell as a partner were made known to those persons and concerns who would be interested in the form of the business—such as Dun and Bradstreet, their bank, their insurance company, and their employees (R. 7-12, 17).[4] Partnership returns were filed for the fiscal years ended September 30, 1944 to 1947, inclusive, which listed Delphia E. Maxwell as one of the partners (Exs. 6-F through 8-H; R. 18).

Petitioner and Fred H. Human were the only partners who performed services for the partnership and they were paid for their services (R. 18-19). Under the original and amended agreements, each of the partners had the right to control his or her share of the income, and during the taxable years involved each of the partners withdrew substantially all of their respective shares. The partners devoted such earnings to their own independent use. (R. 5, 6, 11, 14-15, 18, 19.)[5]

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[4] It is not clear, but it appears that the Tax Court found these facts only insofar as they applied to the original partnership (R. 17); however, the record shows clearly that they applied equally to the introduction of Delphia E. Maxwell as a member of the partnership (R. 7-12, 17).

[5] The Tax Court found only that the "Calloways" devoted such earnings to their own independent use (R. 19); however, the record clearly supports the same findings with respect to all the partners including Delphia E. Maxwell (R. 5, 6, 11).

The Commissioner of Internal Revenue recognized the fact that petitioner and Fred H. Human were bona fide members of the partnership conducted under the name of Lester Maxwell Furniture Company (R. 20). The Tax Court held that Marian and Hasson Calloway were bona fide members of the partnership (R. 20, 21), but refused to recognize that Delphia E. Maxwell was a member of said partnership (R. 20, 24) and held that the amounts credited to her account on the partnership books in accordance with the partnership agreement (substantially all of which she had withdrawn) were taxable to petitioner (R. 24). The Court of Appeals for the Sixth Circuit affirmed the Tax Court (R. 33).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In affirming the decision of the Tax Court which is contrary to the decision of this Court in *Commissioner* v. *Culbertson*, 337 U. S. 733.

2. In finding and holding that the Tax Court properly applied the applicable law in *Commissioner* v. *Culbertson*, 337 U. S. 733, when, in fact, the Tax Court, applied the so-called "original capital" or "vital services" tests which had been discredited as a cure-all in the *Culbertson* case.

3. In affirming the decision of the Tax Court which held that Delphia E. Maxwell did not contribute capital to the partnership conducted under the name of Lester Maxwell Furniture Company, when she purchased from petitioner one-half of his existing interest in said partnership and owned that interest and left it in the partnership.

4. In failing to find and hold that Delphia E. Maxwell, the wife of the petitioner, should be recognized for federal income tax purposes as a partner in the Lester Maxwell Furniture Company.

REASONS FOR GRANTING THE WRIT

1. The decision of the Tax Court, affirmed by the Court of Appeals, is in direct conflict with the decision of this Court in *Commissioner* v. *Culbertson*, 337 U.S. 733. Prior to this Court's decision in the *Culbertson* case, the Tax Court's determination of partnership questions was based on so-called "objective tests" which resulted from misinterpretation of this Court's decisions in *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293.

In the *Culbertson* case, decided June 27, 1949, this Court held that the true test of the validity of a partnership for federal income tax purposes is one of "intent" and in the opinion stated the rule in part as follows:

> The question is not whether the services or capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the *Tower* case, but whether, considering all the facts—the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purpose for which it is used, and any other facts throwing light on the true intent—the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.

In disregard of this Court's pronouncements, the Tax Court, while citing the *Culbertson* case and referring to "intent", "business purpose", and "economic status" in its decisions in partnership cases, persisted in its adherence to the objective tests which this Court repudiated in the *Culbertson* case.

That the Tax Court, after the *Culbertson* case, still persisted in its erroneous interpretation of partnerships is clear from the following observation of Chief Judge

Hutcheson of the United States Court of Appeals for the Fifth Circuit in *Tomlinson* v. *Commissioner*, 199 F. 2d 674:

> This is another of the long list of partnership tax cases in which the Tax Court, with a die-hard persistence in clinging to the objective tests laid down in *Commissioner* v. *Tower*, 327 U.S. 280, has * * * found for the Commissioner undisputed facts which under the rule of *Commissioner* v. *Culbertson*, 337 U.S. 733, require a contrary conclusion.

See also *Turner* v. *Commissioner*, (5th C.C.A.), 199 F. 2d 913, *Levin* v. *Commissioner*, (2nd C.C.A.), 199 F. 2d 692, and *Forman* v. *Commissioner*, (9th C.C.A.), 199 F. 2d 881.

This attitude of the Tax Court apparently was the motivation behind Section 340 of the Revenue Act of 1951. The Senate Finance Committee Report on the section, Sen. Rpt. 781, 82nd Cong., 1st Sess., reads in part as follows (p. 39):

> However, the frequency with which the Tax Court, since the *Culbertson* decision, has held invalid family partnerships based upon donations of capital, would seem to indicate that, although the opinions often refer to "intention", "business purpose," "reality," and "control." they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. * * *

It is clear from the facts of record and the Tax Court's opinion that in deciding the case of this petitioner the Tax Court, while giving lip service to the *Culbertson* decision, did not decide the case upon the substantial evidence of the intention of the parties, but on the basis of certain tests. On the facts in this case the Tax Court held that—

> The partnership capital was not increased by such transaction. No contribution of *independent* capital originating with Delphia E. Maxwell resulted from the

> note transaction. She concedes that she performed no services for the partnership, nor is there any evidence that she at any time participated in the management of policy making. (Italic supplied.)
>
> • • • • • • • • • •
>
> We have recognized all of the partners to be bona fide members of the partnership except Delphia E. Maxwell. She never contributed capital or services to the partnership.

Thus, the Tax Court, as it did in the *Culbertson* case, treated as essential to membership in a family partnership for tax purpose, the contribution of either "vital services" or "original capital." This made decisive what are only "circumstances" to be taken into consideration.

The orderly administration of the tax laws is dependent upon faithful adherence by the lower courts to the authoritative rulings of this Court. Once a question has been resolved by this Court, the failure of any of the lower courts to abide by the result not only produces inequalities of treatment among taxpayers but engenders disrespect for the authority of this Court.

Since the Tax Court decided this case, it has accepted the ruling of this Court in the *Culbertson* case. Cf. *Marcus* v. *Commissioner*, (5th C.C.A.), 201 F. 2d 850, and *Clarence B. Ford*, 19 T.C. 200. However, this fact does not alleviate the necessity for the correction of the lower courts departure from said ruling in this case.

2. The decision of the court below, affirming the Tax Court's holding that Delphia E. Maxwell was not a bona fide partner in the partnership, is contrary to the evidence. The credibility of the witnesses is not involved. The testimony of the various witnesses[6] corroborated each other and the uncontradicted testimony of all of the partners was that they intended to be partners. Other facts of record show

[6] Ten witnesses appeared for the petitioner—all five partners, a competitor, an employee, a representative of Dun and Bradstreet and representatives of the partnership's insurance company and bank. The witnesses were placed under the rule.

the truthfulness of their assertions. The Court's holding that Delphia E. Maxwell contributed no capital to the partnership is based on the erroneous theory that "buying an existing partnership interest" does not make the purchaser a partner.

The testimony and the exhibits establish the agreement. The decision of the lower Court is wrong as a matter of law as well as fact and should be reversed.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari should be granted.

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July 9, 1953.